

VII. COST-OF-SERVICE AND RATE DESIGN

A. Uncontested Rates

1. Rates for Vermilion County, Kankakee and University Park -Water Division

The rates initially proposed by the Company in this case for the Vermilion County, Kankakee and University Park-Water Divisions were based on detailed and comprehensive cost-of-service ("COS") and rate design studies performed by Mr. Guastella. On behalf of Staff, Mr. Johnson also presented COS studies for the same Divisions. Each witness used the Base Cost-Extra Capacity method, under which costs are allocated to functional categories and then allocated to customer groups. Although the manner in which Mr. Guastella applied the Base Cost-Extra Capacity method differed from Mr. Johnson's approach in certain respects, their studies produced similar results. Accordingly, although the Company does not agree with all aspects of Mr. Johnson's methodology, it has accepted his COS studies for purposes of setting water service rates for these three Divisions in this case. Based on the evidence, the Commission finds that those COS studies are reasonable and appropriate for use in developing rates in this case.

In Appendices A, B and C to its Initial Brief, Staff presented schedules containing proposed public and private fire service rates, customer charges and usage charges, developed on the basis of Mr. Johnson's COS studies and designed to produce the revenue requirements for the Vermilion County, Kankakee and University Park Divisions proposed by Staff in Late-Filed Rebuttal Exhibits, filed on February 19, 1998. CIWC accepted Mr. Johnson's recommendation with respect to the manner in which Staff's proposed rates should be adjusted to produce revenue requirements for each Division higher than those proposed by Staff. Under that proposal, if the amount by which the revenue requirement ultimately approved by the Commission for each Division exceeds the revenue requirement proposed by Staff in its Revised Rebuttal Exhibits by 5% or less, the Commission should (i) approve Staff's proposed public and private fire rates and customer charges and (ii) increase Staff's proposed usage rates for each Division by a uniform percentage to produce the increase in revenue requirements approved by the Commission. If the revenue requirement approved for a Division exceeds the revenue requirement proposed by Staff in its Late-Filed Rebuttal Exhibits by more than 5%, the customer charges and usage charges should be adjusted to reflect COS using Mr. Johnson's COS methodology. The Company and Staff proposal in this regard is reasonable with respect to the Kankakee and University Park - Water Divisions and supported by the evidence. In light of the Commission's decision to limit the amount of the increase in the Vermilion County Division's Large General Service Rate to 2.5% (as discussed below) the Commission concludes, based on the evidence, that, for the Vermilion County Division: (I) Staff's proposed public and private fire rate and customer charges should be approved; (ii) Staff's proposed Large General Service Rate should be reduced to reflect a 2.5% increase in that rate; and (iii)

Staff's proposed usage rates, other than the Large General Service Rate, should be increased by a uniform percentage to produce the revenue requirement approved by the Commission.

Public and private fire service rates, customer charges and usage rates for the Vermilion County, Kankakee and University-Park Water Divisions developed in accordance with the above findings are just and reasonable and should be approved.

2. Oak Run Division Rates

The rates for water service in the Oak Run Division consist of a usage charge and a customer charge applicable to metered customers and an availability charge applicable to non-metered customers. CIWC initially proposed a uniform percentage increase in all three charges. Staff witness McDonald accepted the Company's proposed customer charge, but proposed that the usage and availability charges be designed based on a COS study that she performed to allocate costs between metered and non-metered customers. The Company accepted her proposal in this regard. Rates designed to produce the Oak Run Division revenue requirement, as proposed by Staff in its Revised Rebuttal Exhibits, were presented by Staff in Appendix D to its Initial Brief. Ms. McDonald recommended that, if the Commission approves a higher revenue requirement, the customer charge should remain at the level proposed by the Company and Staff's proposed usage charge should be adjusted to meet the increased revenue requirement. CIWC agreed with that recommendation.

Based on the evidence, the Commission finds that the COS study and rate design proposed by Staff and the Company for the Oak Run Division are reasonable and should be approved. The availability charge, customer charge and usage rate developed in accordance with this finding are just and reasonable and should be approved.

3. Woodhaven-Sewer Division Rates

The rate structure for the Woodhaven-Sewer Division consists of a fixed monthly Domestic Rate and a fixed monthly Commercial Rate. The Company and Staff agree that the present Commercial Rate should not be increased and that the Domestic Rate should be increased to produce the increase in annual revenues approved by the Commission. The Commission finds that this proposal is just and reasonable and should be approved.

4. Miscellaneous Charges

The Company presented evidence supporting its proposal to increase the service reconnection and returned check charges for the Vermilion County, University Park-Water, Oak Run and Woodhaven-Sewer Divisions to \$25 and \$15, respectively equal to the levels of such charges presently in effect for the Kankakee Division. Staff

witnesses Johnson and McDonald presented testimony supporting this proposal. Based on the evidence, the Commission finds that CIWC's proposed service reconnection and returned check charges are just and reasonable and should be approved.

The Company initially proposed that all miscellaneous charges be included in new standardized Rules, Regulations and Conditions of Service (the "Rules"), presently under review by Staff. As discussed in Mr. Maurer's Surrebuttal Testimony, however, Staff has suggested (and the Company has agreed) that the miscellaneous charges for which increases have been approved in this Order, as well as all other miscellaneous charges, be removed from the Rules and included in a tariff sheet for each of the Company's Divisions. In accordance with Staff's suggestion, the Company intends to submit Rules (in a separate filing unrelated to this case) which refer to, but do not set forth the amount of, the miscellaneous charges. The Commission finds that this proposal is reasonable and should be approved. (The Company should be, and hereby is, directed to file tariff sheets pursuant to this Order which set forth all current miscellaneous charges for the five Divisions included in this filing, including those approved in this proceeding).

B. Contested Rates

1. Large General Service Rate

The Company initially proposed that the Vermilion County Division's Large General Service Rate be increased by 25%, somewhat above the overall average percentage increase, to provide movement toward cost-of-service for Teepak, the customer served under that rate. Teepak presented testimony recommending that the increase in Large General Service Rate be limited to 2.5%. Teepak contends that it has the ability to construct its own water supply and discontinue water purchases from CIWC. Teepak further contends that if its 2.5% rate increase proposal is not accepted, it would construct its own well system, thus bypassing CIWC's system. This would cause great harm to its remaining customers. Mr. Johnson concluded that the study performed by Teepak of the cost to produce water did not include the treatment of waste products or the cost that would be incurred for taking standby service. Accordingly, Staff proposed to limit the increase to the total system increase. The evidence shows that acceptance of Teepak's proposal would result in further movement away from cost-of-service. CIWC accepted Mr. Johnson's proposal to apply the overall percentage increase approved for the Vermilion County Division in this case to the Large General Service Rate.

The Commission finds that Teepak's proposal should be approved. At a time when CIWC has substantial excess capacity and the Company is experiencing declining sales due to losses of industrial customers, Teepak leaving the system would do great harm to both the Company and CIWC's remaining customers. Therefore, a

Large General Service Rate increase of only 2.5% is reasonable and should be approved.

2. Standby Service Tariff

a. Summary of Company's Proposal

In this proceeding, the Company proposed Standby Service Tariffs, for the Vermilion County, Kankakee and University Park-Water Divisions, which contain rates, terms and conditions of service applicable to any customer (a "Standby Customer") that has a New Alternative Source of Supply (a "NASS"). A NASS is defined generally as an external or internal source of supply, other than the Company, which (i) has capacity available to provide the Standby Customer with at least 300 ccf of water per day on average; (ii) supplies or is intended to supply water which would, to the extent that the source becomes unavailable to meet the customers' needs, be otherwise provided by the Company; and (iii) is placed in service on or after the effective date of the Tariff.

By definition, Standby Customers are those entities that rely on the Company's system for use as a back-up, auxiliary or reserve source of supply when their NASSes are inoperative or inadequate to meet their demand for water. Such customers have the potential to increase demand on CIWC's system dramatically on a short term and sporadic basis and CIWC must have the water supply and distribution facilities available to meet that demand. 220 ILCS 5/8-101. Under the Company's General Water Service Tariff, however, fixed costs are recovered through volumetric usage charges. Accordingly, a Standby Customer, that periodically imposes significant demands on the system but purchases a relatively small amount of water annually, will not provide revenues under the General Water Service Tariff sufficient to cover the fixed costs incurred to provide Standby Service to that customer. Mr. Guastella testified that the proposed Standby Tariff contains rates which properly reflect the cost of Standby Service.

Under the proposed Tariff, each Standby Customer is required to enter into a Standby Service Contract ("Contract") and pay the charges specified in the Tariff. The Contract identifies the Customer's Contractual Maximum Daily Standby Demand ("Contractual Demand"), i.e., the maximum daily amount of water that CIWC is obligated to provide as a standby source of water in the event that the Standby Customer's NASS becomes unavailable or deficient. The Contractual Demand is equal to either (i) the capacity of the Standby Customer's NASS or (ii) such other reasonable amount to which the Customer may agree.

The Standby Tariff contains three rate components. The first component is a Customer Charge, equal to the monthly customer charges by meter size set forth in the General Water Service Tariff. The second component is a monthly Demand Charge which will be applied to the full amount of the Customer's Contractual Demand (regardless of whether the customer uses water in that amount). Mr. Guastella testified

that the Demand Charges for each Division are designed to recover the "base" portion of the fixed costs incurred by the Company to maintain the facilities necessary to meet standby demands. The third component is a volumetric usage rate applicable to water actually used. For monthly usage up to the level of the Standby Customer's Contractual Demand, the volumetric rate for each Division is equal to the variable cost of power and chemicals. For monthly usage in excess of the Contractual Demand, a Standby Customer will be charged in accordance with the otherwise applicable General Metered Water Service schedule of rates.

The Tariff also contains provisions applicable to (i) Standby Customers which fail to enter into a Contract, and its (ii) Standby Customers which use standby water in excess of their Contractual Demand. Mr. Guastella and Mr. Cummings insisted that these provisions are necessary to provide appropriate incentives for Standby Customers to comply with the Tariff requirements and to ensure that such Customers pay for the full cost of Standby Service.

The Company asserts that the terms, conditions and rate structure of the Standby Service Tariffs proposed by the Company are in most respects identical to those of the Standby Service Tariff recently approved in Illinois-American, Dockets 97-0102/97-0081 at 45-49 (December 22, 1997). According to the Company, the Tariff approved for Illinois-American differs in two significant respects. First, the Commission determined that Illinois-American's Tariff should be applicable to customers which rely on the utility system as back-up for existing, as well as NASSes with a capacity of at least 300 ccf. *Id.* at 46-47. Mr. Cummings indicated that CIWC would not object to expanding the applicability of its Standby Service Tariff in this manner. The Commission also rejected the Excess Usage Charge provisions of Illinois-American's proposed Tariff and adopted, instead, penalties intended to discourage Standby Customers from "gaming" the system to avoid paying for the full cost of Standby Service. (Order, Docket 97-0102/97-0081 at 46-47). The Company contends that, based on the record in this proceeding, the Commission should approve CIWC's proposed Excess Usage Charge provisions.

Mr. Johnson also proposed Standby Service tariffs applicable to Standby Customers with a NASS. His proposal, however, differs from CIWC's proposal in a number of significant respects. The differences between the Staff and Company proposals are discussed in detail below.

3. Standby Service Demand Rates

a. Positions of the Parties

The monthly Standby Demand Charges proposed by the Company are \$28.53 per ccf of Contractual Demand for the Vermilion County Division, \$16.21 per ccf of Contractual Demand for the Kankakee Division and \$26.43 per 1,000 gallons of Contractual Demand for the University Park Division. As previously indicated, these

demand charges were designed to recover the "base" portion of the fixed costs incurred by CIWC to maintain the facilities necessary to meet standby demands.

Staff's proposed daily demand charges, as restated on a monthly basis, are \$9.43 per ccf for the Vermilion County Division, \$7.90 per ccf for the Kankakee Division, and \$6.08 per 1,000 gallons for the University Park-Water Division. Generally, Staff has four objections to CIWC's standby service methodology. First, Staff believes that the Company would be providing system reserve capacity to standby customers and that rates should be based on that premise. It asserts that standby reserve charges should be based upon excess maximum day costs since those costs are associated with reserve capacity. Staff has demonstrated that excess capacity is readily available in the three divisions and that it is in everyone's best interest for CIWC to sell extra water. Current customers are paying for excess capacity.

Staff maintains that, when determining a demand charge, only those costs associated with reserve capacity should be considered. Mr. Guastella proposed a demand charge consisting only of base costs. Staff found that this demand charge does not take into account the excess maximum day capacity costs. Staff contends that Mr. Guastella erred by failing to remove small mains from his standby calculation in the Kankakee and University Park Water Divisions, since standby customers generally are larger customers who do not benefit from the small main grid distribution system. Staff asserts that maximum day capacity is more reflective of the ability of the CIWC system to meet standby customer demands, and its demand charge reflects the cost per ccf associated with having capacity available on the maximum day.

Mr. Guastella explained that, in calculating his proposed demand charges, Mr. Johnson took into account only that incremental portion of the cost of maximum day capacity which is allocated to the "maximum day-extra capacity" function. For example, Mr. Guastella noted that water treatment plant is designed generally to meet system maximum day demands and, therefore, its total cost is directly related to maximum day demands. Under the Base Cost-Extra Capacity method, a portion of the total cost of the water treatment plant is allocated to the "base" function (according to the ratio of the system's average day to maximum day demand), and a portion is allocated to the "maximum day-extra capacity" function (according to the portion of the maximum day demand in excess of the average demand). Using Mr. Johnson's figures for the Vermilion County Division, the maximum day demand was 11.869 MGD; the average day demand was 9.267 MGD (78.1% of the maximum day) and the portion of the maximum day in excess of the average day demand was 2.602 MGD (21.9% of the maximum day).

Second, Staff maintains that it has compensated properly for the diversity effects of standby customers by including excess maximum day costs only in the demand charge. Staff's proposed commodity charge is designed to recover those costs associated with actual water usage and, in combination with the demand charge, reflects the total costs that standby customers put on the system. CIWC's demand and

commodity charges reflect only base costs. The differences in methodologies between Staff and CIWC stem from the Company following the dictates of Illinois-American, Dockets 97-0102/97-0081, Order at 29, which found that the volumetric usage rate would be based on variable operating costs which are purchased power and chemical expense.

CIWC contends that, in calculating his proposed standby charge for the Vermilion County Division, Mr. Johnson took into account only 21.9% of the total cost of the water treatment plant, i.e., that portion of the total costs allocated to the maximum day-excess capacity function. The Company, therefore, contends that Staff's proposed demand charge does not recover the costs associated with having capacity available for Standby Customers when they need to use it. Mr. Guastella asserted that Staff's proposed demand charges reflect only about 16% of the "cost per ccf associated with having capacity available on the maximum day." Therefore, CIWC concludes that those demand charges would not come even close to accomplishing Mr. Johnson's goal of ensuring that Standby Customers "pay for the costs they place on the system and that other customers should not absorb those costs." (Staff Ex. 4 at 20).

CIWC notes that Staff's proposed usage charges reflect 78.1% of the total cost of the Vermilion water treatment plant. Mr. Johnson acknowledged that during a billing period in which the Standby Customer does not use any water, that Customer would not pay any usage charges and would not, therefore, contribute anything toward the recovery of the "base" portion of the costs of maximum day capacity. Mr. Guastella asserted that, as a result, General Water Service Customers, who use water year-round, would subsidize the cost of providing standby service under Staff's approach. Since Mr. Johnson's proposed demand charges reflect only 16% of total maximum day demand-related costs, Mr. Guastella contends that the concept of "diversity" cannot justify such a result.

Mr. Guastella also testified that, for a water company to rely on diversity of demand in the design of its system, there must be a sufficient number of customers to be statistically certain that the total demand will be less than the sum of each customer's demand. For example, if a utility had only two customers, each with a maximum demand of 100 GPD, the system must be designed for 200 GPD because the chance of both customers taking water on the same day cannot be ignored in reliance on diversity of demand. He noted that CIWC currently does not have any Standby Customers and the potential number of Standby Customers is unknown. He also emphasized that there are no restrictions as to the day or hour on which a Standby Customer may obtain water up to the level of its Contractual Demand and that CIWC's proposed Demand Charges reflect the cost of the facilities which must be available to meet the demand of the Standby Customer whenever that demand occurs. Moreover, the Contractual Demand of the potential Standby Customer should not be based on use of the Company as a peaking facility, but as a back-up source of water for the NASS. According to Mr. Guastella, the varying amounts of water that a Standby Customer may use from its own facilities is irrelevant for purposes of developing

Standby Service rates. For these reasons he concluded that there is no basis for reducing CIWC's proposed standby demand charges to reflect "diversity of demand".

CIWC further notes that its approach is somewhat different than that of Illinois-American. There the demand charge reflects all of the fixed costs of the facilities needed to meet on- and off-peak demand. In the instant docket, the Demand Charge for the Vermilion County Division reflects 78.1% of the cost per ccf of that Division's water treatment plant.

Third, Mr. Johnson proposed that the contractual maximum daily demand level should be equal to a reasonable level to which the customer agrees and that the contracted demand may be re-subscribed on an annual basis. CIWC's provision calls for the Contractual Maximum Daily Standby Demand to be equal to either (I) the total capacity of the Customer's NASS or (II) such other reasonable amount to which the Company and Standby Service Customer may agree. Staff maintains that the customer is the best judge as to the level of standby it will need. Additionally, Staff maintains that its penalty provisions will prevent a customer from subscribing to an incorrect level because it will not want to pay a penalty charge that is set at or above the first block rate for firm customers; potentially be ratcheted up in the summertime when capacity may be short; and have daily usage above subscribed levels restricted if the Company cannot meet the requirements of 83 Ill. Adm. Code 600.230.

The Company contends that this provision is reasonable because a Standby Customer is, by definition, an entity that relies on the Company's system for use as back-up for the Customer's NASS. CIWC also states that this provision is consistent with the comparable provision of Illinois-American's Standby Service Tariff, approved in Dockets 97-0102/97-0081, Order at 28-29. The Company states that Staff's position would give a Standby Customer the unrestricted ability to become a "free rider," i.e., to nominate, and pay for, a level of Contractual Demand which is far less than the amount of standby capacity that the Customer actually is relying on as back-up for its alternative supply.

Fourth, while Staff agrees that standby service should be available to any customer that has a NASS with a capacity of 300 ccf per day, it proposes that CIWC, in its next rate proceeding, provide evidence on the reasonableness of excluding customers that have standby demand of less than 300 ccf on average. This is a reasonable Staff request and will be required by the Commission.

b. Commission Conclusion

The principal issue to be decided is whether CIWC's Standby Demand Charge should be based, in part, on an allocation of part of the total cost of the water treatment plant, in accordance with the Company's Base Cost-Extra Capacity Method. Both the Company and Staff have made good points in support of their positions. Staff rightfully points out that CIWC has excess water capacity to sell, for which current customers are

paying. On the other hand, the Company correctly points out that the Staff's proposed demand charges reflect only 16% of the cost per ccf of having standby capacity available on the maximum day. CIWC also properly notes that Staff's proposal cannot be justified on the basis of diversity of demand because CIWC does not presently have any Standby Customers and the potential number of Standby Customers is unknown.

Without having any Standby Customers, it is difficult to determine an appropriate level of demand charges for CIWC. What we must encourage is the establishment of standby service in order to reduce CIWC's excess capacity.. We believe that Staff's proposed demand charge for Standby Customers based only on those costs associated with reserve capacity will accomplish that goal. The Company's modification of the Illinois American Standby Tariff, in our judgment, would discourage potential standby customers by creating excessively high rates on top of requiring a potential standby customers to pay the costs of digging its own well. Accordingly, the Commission approves Staff's Standby Demand and Usage Charge methodologies

We agree with CIWC that there must be mutual agreement by both the customer and the Company regarding the level of standby service needed by the customer. Cooperation and understanding between these parties is essential in establishing Standby Service for the Company.

In addition, the Commission concludes that the proposed demand restrictions, as proposed by Staff and accepted by CIWC, which allow restrictions on daily standby usage above the amount subscribed whenever the Company is unable to meet the requirements of 83 Ill. Adm. Code 600.230 in a Division, should be included in the standby tariffs. The language to be included in the tariffs shall be as proposed by Staff in its draft Standby Water Service tariff (Staff Ex. 4, Schedule 3 at 6), and accepted by CIWC (CIWC Ex. 7 at 25).

c. CIWC Exceptions

CIWC maintains that the Staff-approved demand charges are contrary to the Illinois American Order, Dockets 97-0102/97-0081. Moreover, their approval grossly understates the costs incurred by the Company. Staff's demand charges do not reflect the cost of capacity available. CIWC does not acknowledge that it has excess capacity, instead, it claims that it needs reserve capacity to ensure reliability of service. The Company also contends that the Staff's demand charges do not provide appropriate pricing signals to Standby Customers, thus increasing the risk of uneconomic bypass. Further, CIWC asserts that it will lose customers' significant contribution to the recovery of fixed costs through General Water Service Rates. Accordingly, General Water Service Customers would subsidize Standby Customers.

In response, Staff avers that the Company's demand charge does not take into account the excess maximum day capacity costs and the maximum day capacity is

more reflective of the ability of the CIWC system to meet Standby Customers' demands. Staff points out that the Company agreed with Staff's COSS which included the proposed maximum day figures and since neither Staff nor CIWC proposed an adjustment to rate base to exclude capacity beyond the maximum day, and since there are currently no Standby Customers on the system, current customers are paying for that capacity.

Staff also seeks to support the Order's adoption of its Standby Commodity (Usage) Charge. While CIWC contends that Staff's commodity charge is not designed to recover the costs of actual usage and, in combination with the demand charge, does not reflect total system costs, Staff maintains that its usage charge reflects total base costs on the system. Staff further contends that under the Company's proposal, when Standby Customers do take water, they are only paying for base costs and the general water service customers are subsidizing the excess maximum day costs for which Standby Customers are responsible.

The foregoing exceptions have not altered our opinion that Staff's proposed demand and usage charges are appropriate. We agree with the Staff's arguments. If the Company does not have excess capacity, it should not be proposing standby rates. The offering of standby service assumes excess capacity and the Company's attempt to prevent uneconomic bypass. At present, without any Standby Customers, the Company's General Water Service Customers are paying all fixed costs. The demand charge approved by us will alleviate a part of that burden.

4. Standby Penalty Charges

Staff proposed penalty charges which double the demand charge and add \$0.50 per ccf for all daily usage above the subscribed levels. The customer also would pay the usage charge for all water taken. Staff contends that its proposal would deter over-consumption since customers who over-consume would be penalized on a daily basis. If customers take more than their subscription amount in the summer months, they would be ratcheted automatically up to the higher amounts for the succeeding 12 months. Also, there can be usage restrictions imposed pursuant to 83 Ill. Adm. Code 600.230. Staff contends that its penalty charge balances the need to control over-consumption and recognizes that standby customers have the potential of generating revenues which contribute to costs that otherwise would be paid by general ratepayers.

Staff's penalty charge has the positive effect of restraining over-consumption so that reserve capacity can be distributed in a controlled environment. Staff provides the following example. If a customer started taking standby service in January 1998 with a contracted demand of 500 ccf per day and then in January 2000 uses 550 ccf on only one day, under the Company's proposed Vermilion Division standby rate the customer would pay an excess penalty charge of \$34,236 ($\28.53×50 ccf for 24 months). This customer would be penalized \$34,236 for just one day of over-subscription. Staff asserts that this penalty is excessive and could depress sales of reserve capacity.

Additionally, it argues that its penalty charge uses the same methodology approved in NIWC's recent rate case, Docket 97-0254.

The Company proposes that a Standby Customer that fails to enter into a Contract and pay for Standby Service in accordance with the terms of the Tariff would, as a condition for obtaining standby water from the Company in an amount equal to or greater than 300 ccf on average per day for a billing period, be required to pay an Excess Usage Charge. This charge is equal to the amount of Demand Charges that the customer would have paid during the period when it was a Standby Customer, but failed to pay for standby service, up to a maximum of 24 months. The Customer also would be required to enter into a Standby Service Contract, pursuant to the terms and conditions of the Tariff, for a period of at least 12 months.

A Standby Customer whose Actual Demand exceeds its Contractual Demand also would be subject to an Excess Usage Charge, calculated on the basis of the period of time during which the Standby Customer under nominated its standby demand, up to a maximum of 24 months. The Excess Usage Charge in this circumstance is equal to the difference between the total amount of Demand Charges that the Customer would have paid if it had accurately nominated its standby demand and the total amount of Demand Charges which the Customer actually paid during the period for which the Excess Usage Charge is calculated. Such a customer also would be required, on a prospective basis, to pay Demand Charges based on the Actual Demand (or such higher amount as the Company and the Customer shall agree) for a period of not less than 12 months. The Company contends that it is inappropriate to require General Water Service Customers to pay the cost associated with facilities needed to support Standby Service during this period.

Mr. Guastella testified that the service being provided is the maintenance of capacity needed to meet the Customer's standby water requirements and a customer receiving such back-up service should be responsible for paying the costs associated with the capacity maintained to provide that service, even during billing periods when the Customer does not actually take water service from the utility.

CIWC asserts that the Excess Usage Charge is not a "penalty". Instead, the Company contends, it is a cost-based charge and is fully consistent with the Commission's policy on "Unbilled Service", which provides that "[a] utility may render a bill for services or commodities provided to . . . [a] non-residential customer" for a period of time up to "two years [i.e., 24 months] after the date the services or commodities were supplied". 83 Ill. Adm. Code 280.100.

The Company also contends that the Excess Usage Charge is necessary to discourage "free riders", i.e., Standby Customers who choose not to pay for Standby Service (or who fail to nominate an adequate level of Contractual Demand) until such time that they actually require standby water from the Company. According to Mr. Guastella, revenue received by the Company under the Excess Usage Charge

would provide a source of operating revenue which (with appropriate normalization) would offset the revenue requirements assigned to other customers in future rate cases.

Teepak witness Brubaker asserted that the Excess Usage Charge provisions discriminate against Standby Customers because similar payments are not required from new General Water Service Customers, or from existing General Water Service Customers who increase their demands on the Company's system. CIWC contends that Mr. Brubaker's criticism is unwarranted. Mr. Guastella testified that the usage rates applicable to General Water Service Customers are designed to recover both the fixed and variable costs of providing general water service. These customers can be expected to purchase water regularly and pay rates which reflect the associated costs. In contrast, a Standby Customer, with its alternative supply, may be in a position to take no water from the Company for an extended period of time. Mr. Guastella explained that this difference in circumstances between General Water Service Customers and Standby Customers supports the application of the Excess Usage Charges. Without such a charge, there would be no mechanism for recovery of the costs of facilities essential to provide Standby Service for what would be an extended period of time (from the time that a NASS is developed until a need arises to draw water from the Company). CIWC contends that it is inappropriate to require General Water Service Customers to pay the cost associated with facilities needed to support Standby Service during this period.

The Company contends that Staff's proposed demand charges grossly understate the actual cost of Standby Service. CIWC concludes, therefore, that the Standby Customer would have avoided paying (and General Water Service Customers would be required to subsidize) Standby Service costs in an amount far greater than 10 times the amount of Staff's proposed "penalty". In contrast, the Company asserts, its proposed Excess Usage Charge is precisely equal to, and offsets exactly, the Demand Charge savings realized by a Standby Customer as a result of undemominating its Contractual Demand for a period of time up to 24 months.

The Company further contends that the amount of Demand Charges paid during that prospective period does not reflect recovery of any portion of the cost of the capacity relied on by the Standby Customer for back-up service during prior periods of time when the customer received, but failed to pay for (or paid for less than the full amount of) Standby Service. CIWC also notes that Mr. Johnson's proposed "ratchet" provision would not apply to a Standby Customer which takes standby water in excess of its Contractual Demand during the "non-summer" period from October 1 through May 31.

Mr. Guastella testified that the requirement that a Standby Customer pay for the full amount of the capacity relied on for back-up service should apply regardless of the month during which the Customer's Actual Demand exceeds its Contractual Demand

The Commission concludes that Staff's penalty charge and methodology are more reasonable than those proposed by the Company. CIWC's penalty charge is excessive. The mere threat of having so great a penalty charge would deter the likelihood of having standby customers in the first instance. Thus, the primary goal of having standby service is to sell the Company's excess water and this goal would be thwarted by instituting its Excess Usage Charge.

In its exceptions, CIWC again points out that the Staff's proposed penalty charges are contrary to the previously cited Illinois-American Order, wherein the Commission approved penalty charges two times Illinois-American's demand charges. Similar to its exceptions regarding Standby Demand Charges, the Company contends: (1) its penalty charge is cost-based; (2) Staff's penalty charges send improper price signals and give no incentive to comply with the Standby tariff; and (3) a customer would avoid a penalty charge by entering into a Standby Contract and accurately nominating its Contractual Demand.

Staff has pointed out that Standby Customers will not want to pay a penalty charge that is set at or above the first block rate for firm customers; potentially to be ratcheted up in the summertime when capacity may be short; and have daily usage above subscribed levels restricted if the Company cannot meet the requirements of 83 Ill. Adm. Code 600.230. Staff maintains that Standby Customers should be ratcheted upwards in recognition of the added demand they put on the system. However, in non-peaking months, a Standby Customer should be penalized for over-consumption, but should not be penalized through ratcheting if sufficient capacity is available. Thus, Staff concludes that its penalty charge balances the need to control over-consumption with the desire to obtain additional revenues which would contribute to the costs otherwise paid by General Service Customers.

We agree with Staff's arguments. We would also note that this is the Company's initial standby proposal. While we have no history to determine how this Company's Standby Customers might react to high penalty charges, if such charges are excessive, this is another reason for a customer to bypass the Company and not contract for standby service.

5. Customers Which Fail to Contract for Standby Service.

Mr. Johnson also proposed that no penalty be applied to a Standby Customer that fails to enter into a Contract. Instead, Staff proposed that customers who do not subscribe to a level of daily standby capacity, but are current customers, should have their standby capacity determined by the highest daily usage during the prior twelve months. For the first twelve months after the effective date of this tariff, "prior twelve months" would mean the period subsequent to the effective date of the tariff through the then prior month. For new customers who refuse to subscribe, Staff would not oppose the refusal of water service to that customer. However, it is Staff's opinion and

experience that companies would want to work with customers so that a situation like this would not occur.

In response, CIWC notes that, with respect to the example discussed above, Mr. Johnson testified that the Company would have an obligation to provide back-up water in the amount of 1,000 ccf on January 1, 2000, as requested by the Standby Customer, even if the Customer had failed to enter into a Standby Service Contract, thereby avoiding payment for any portion of the cost of the back-up capacity relied by that Customer for the period from January 1, 1999 through December 31, 1999. Under his proposal, that Customer would not be required to pay Staff's "penalty" as a charge or a condition for obtaining that water. The Company contends that under Staff's approach, a Standby Customer would have every incentive to "game" the system by electing not to enter into a Contract (or by undernominating its Contractual Demand), thereby paying nothing for (or less than the full cost of) facilities maintained to provide the Customer with back-up service.

Staff also pointed out that capacity is readily available and it is to everyone's advantage to sell the extra water. CIWC argues that the service being provided, even when a customer does not actually take water, consists of the maintenance of capacity needed to meet the customer's standby waters requirements. However, reserve capacity was not put in place just to serve Standby Customers. The maintenance of capacity is already supported by current customers and will continue to be supported by current customers, if potential Standby Customers bypass the system because of inappropriate price signals. Standby Customers should not be assessed a penalty charge for capacity that is considered reserve capacity.

The Company also argued that Staff's proposal is inconsistent with Illinois-American, Dockets 97-0102/97-0081. There, the Commission determined that a Standby Customer that fails to enter into a contract and pay for Standby Service in accordance with the terms of the Tariff would, as a condition for obtaining water from the utility in an amount equal to or greater than 300 ccf on average per day for a billing period, also be required to pay a penalty equal to twice the monthly demand charge.

Our review of the evidence indicates that our decision in the Illinois American case cited above is equally applicable herein. Accordingly, the Standby Customer which fails to enter into a contract should be penalized as previously set forth.

The evidence summarized above supports the Company's position that, under Staff's proposal, a Standby Customer would have every opportunity to "game" the system by electing not to enter into a Standby Contract (or by under-nominating the Contractual Demand), thereby paying nothing for (or less than the full cost of) the facilities maintained to provide the Customer with back-up service. As a result, other customers would be called upon to subsidize the cost of capacity relied upon by the Standby Customer. Such a subsidy is improper. The evidence also supports the Company's proposal that a Standby Customer whose Actual Contractual Demand

exceeds its Contractual Demand should be required, on a prospective basis, to pay demand charges based on the Actual Demand regardless of the time of year in which the exceedance occurs. The Company's proposal in this regard is consistent with the Commission's decision in Illinois-American Water Company, Dockets 97-0102 and 97-0081 (Consolidated). The Commission agrees with the Company that the requirement that a Standby Customer pay for the full amount of the capacity relied on for back-up service should apply regardless of the month during which the Customer's Actual Demand exceeds the Contractual Demand.

Based on all of the foregoing, the Company should file tariff sheets which reflect all of the conclusions set forth in this Section of the Order.

VIII. WATER QUALITY

During the proceeding, Staff requested that the Company address certain concerns regarding water quality which were raised at public forums in the University Park and Oak Run Divisions. With respect to comments made at the University Park forum regarding water hardness, Mr. Saller testified that the water supply in University Park complies with all water quality standards and that the hardness content is typical of other groundwater supplies used to provide service in surrounding communities. He asserted that the hardness content of the water has no adverse health effects. He also indicated that CIWC takes a number of steps to minimize coloration of the water caused by iron, including flushing of hydrants and the use of sodium silicate as an iron sequestering agent.

Mr. Saller explained that CIWC has been responsive to customers' concerns regarding water quality in University Park. For example, in 1994, CIWC conducted a survey requesting customers to rate the Company on its customer service, taste of the water, water hardness and iron problems. It also offered options for improving water quality which customers were also asked to select. The survey results indicated that customers overwhelmingly rate the water hard, but fair in taste. Iron was not deemed to be a problem. Respondents indicated that they were unwilling to pay more for soft water. Mr. Saller stated that, in response to comments at the December 2, 1997 Public Forum, CIWC will conduct another water quality survey in early 1998 to readdress the issue of water hardness in University Park.

In response to comments made at the Oak Run Division public forum regarding the chloride content of that Division's water supply, Mr. Seehawer testified that Oak Run's water supply fully complies with the water quality standards established by the Illinois Environmental Protection Agency ("IEPA") in accordance with the Safe Drinking Water Act. Chloride content is not regulated under those standards. The safety of the Oak Run Division supply is not affected by chloride content. A concern was also expressed that the "aggressive" nature of the Oak Run water might reduce the longevity of hot water heaters. Mr. Seehawer noted that, with proper maintenance, hot water heaters will last their normal expected life span with the Oak Run water. He

stated that the Company has taken a number of steps to improve Oak Run's water quality, including (i) changing the treatment process to a chlorine oxidizing agent with a plain sand filter and (ii) installing a SCADA system to provide for more efficient operation of the water treatment plant. He opined that, to eliminate chlorides, a reverse osmosis plant would have to be installed. The only other alternative would be to obtain another source of water, i.e., purchase water from Galesburg by extending a 20-mile pipeline to Oak Run. Both options are very expensive and would result in a significant increase in water rates.

Based on the evidence, the Commission finds that the Company has appropriately addressed the concerns raised.

IX. FINDINGS AND ORDERING PARAGRAPHS

The Commission having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Consumers Illinois Water Company (the "Company") is a corporation engaged in the business of furnishing water and sewer service to the public in the State of Illinois and, as such, is a public utility within the meaning of the Public Utilities Act;
- (2) the Commission has jurisdiction over the Company and of the subject matter hereof;
- (3) the recitals of fact and the conclusions reached in the prefatory portion of this Order are supported by the evidence and are hereby adopted as findings of fact;
- (4) for the adjusted Test Year ended December 31, 1996, and, for purposes of this proceeding, the Company's original cost rate bases for ratemaking purposes are as follows: \$30,026,693 (Vermilion); \$17,480,405 (Kankakee); \$1,461,324 (University Park-Water); \$948,101 (Oak Run); \$2,179,618 (Woodhaven-Sewer);
- (5) a fair return on the original cost rate bases for the Divisions identified in Finding (4) is 9.41%, which incorporates a rate of return on the Company's common equity of 10.06%; rates should be set to allow the Company an opportunity to earn this rate of return on its original cost rate bases, as determined herein;
- (6) the rates of return set forth in Finding (5) hereinabove result in the following levels of annual operating revenue: \$8,860,004 (Vermilion); \$7,754,100 (Kankakee); \$724,896 (University Park-Water); \$310,554 (Oak Run); and \$742,653 (Woodhaven-Sewer); to receive this operating

revenue, increases in annual revenue should be allowed as follows: \$1,007,653 (Vermilion); \$657,405 (Kankakee); \$112,470 (University Park-Water); \$69,610 (Oak Run); and \$126,664 (Woodhaven-Sewer);

- (7) the Company's present rates are insufficient to generate operating income necessary to provide a fair and reasonable return on its rate base; such rates should be permanently canceled and annulled;
- (8) the tariff sheets initially filed by the Company in this proceeding contained rates which would produce a rate of return in excess of a return that is just and reasonable; said tariff sheets should, therefore, be permanently canceled and annulled;
- (9) the Company should be authorized to place into effect tariff sheets for the Divisions which will produce the annual revenues set forth in Finding (6) hereinabove in substantially the same form as set forth on Appendix B of this Order, to be effective within three days of the date of filing;
- (10) the rates and tariffs filed by the Company should be designed in accordance with the cost of service and rate design determinations made in the prefatory portion of this Order;
- (11) all motions and objections made in this proceeding which remain undisposed of should be considered disposed of in a manner consistent with the ultimate conclusions contained therein.

IT IS THEREFORE ORDERED that the tariff sheets containing rate schedules proposing a general increase in rates filed by Consumers Illinois Water Company on July 11, 1997, are hereby permanently canceled and annulled.

IT IS FURTHER ORDERED that Consumers Illinois Water Company is hereby authorized and directed to file tariff sheets placing into effect new rates and charges in accordance with Findings (9) and (10), such new tariff sheets to become effective three days after the date of filing, for water and sewer service furnished on and after such effective date.

IT IS FURTHER ORDERED that, upon the effective date of the tariff sheets filed pursuant to this Order, the presently effective tariff sheets of Consumers Illinois Water Company which are replaced thereby are hereby permanently canceled and annulled.

IT IS FURTHER ORDERED that any objections and motions that remain undisposed of be, and the same are hereby, disposed of consistently with the ultimate conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Admin. Code Section 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 3rd day of June, 1998.

Chairman